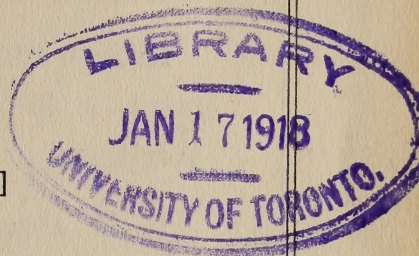


INCOME TAX PRIMER

PREPARED BY THE
BUREAU OF INTERNAL REVENUE

FOR
COLLECTORS

[December 17, 1917.]



SECOND REPRINT FOR GENERAL DISTRIBUTION

ORIGINALLY REPRODUCED BY THE CORPORATION TRUST
COMPANY AS A SUPPLEMENT TO ITS INCOME TAX SERVICE.

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The War Revenue Act of 1917 is being administered by the Treasury Department.

The construction placed by that Department upon the language of the statute is controlling unless and until the courts decide otherwise.

Rulings and regulations issued by that Department state its construction of the various provisions.

It is absolutely necessary to know these rulings and regulations in order to understand the practical operation of the law and the taxpayer's rights and duties thereunder.

The Corporation Trust Company's Income Tax and War Tax Services afford the best means to keep posted on the law and the regulations, rulings, court decisions and official opinions thereunder.

These Services, by their promptness, completeness, accuracy and convenience for reference, have become recognized as the leading authorities on Federal Taxation.

For full description of these Services see page 31

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This is not a "Treasury Decision."

[December 17, 1917]

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[The references are to question numbers.]

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RETURNS.

1. *Am I Required to Render a Personal Income Tax Return for the Year 1917?*

Yes, if unmarried and your net income for that year equals or exceeds \$1,000. If you are married no return is required unless your net income, including that of your husband or wife, equals or exceeds \$2,000.

If you act as the guardian of a minor or incompetent person, or as the administrator, executor, or trustee of an estate or trust, a return will be required of you for and in behalf of your ward, or the estate or trust for which you act, if the conditions outlined under the head of "FIDUCIARIES," as requiring a return, are present in your case.

2. *Where Should My Personal Return for the Year 1917 be Filed?*

Section 8 (a) of the Act of September 8, 1916, provides that your return may be filed with the Collector of Internal Revenue for the district in which you have your legal residence or principal place of business. If your legal residence is located in one Collection District and your principal place of business in another, it is optional with which Collector your return shall be filed; but for administrative reasons the Commissioner of Internal Revenue desires that it be filed with the Collector of the District in which your legal residence is located.

3. *When May My 1917 Return be Filed With a Collector of Internal Revenue?*

On any day after December 31, 1917, but not later than March 1, 1918.

4. *Will Failure to File My Return Within the Time Prescribed by Law Render Me Liable to any Penalty?*

Yes. Under the provisions of Section 18 of the Act of September 8, 1916, as amended, you will be liable to a specific penalty of not less than \$20 nor more than \$1,000 if you fail to have your 1917 return in the office of the Collector of Internal Revenue for your District before the close of business on March 1, 1918; and, under the provisions of Section 3176, Revised Statutes, you will also be liable to 50% additional tax.

Therefore, you should use extreme care to see that your return is placed in the mails in ample time to reach the office of your Collector before the close of business March 1, 1918.

5. *May an Extension of Time Beyond March 1, 1918, be Obtained for the Filing of My 1917 Return?*

Yes. If, on account of illness or absence from home, you are unable to render your return within the time prescribed by law, you may obtain an extension of thirty days if a request therefor is filed with the Collector of your District before the due date of the return. (See Section 3176, Revised Statutes.) In this request you must state the reason why the return cannot be filed within the time prescribed by law.

Collectors of Internal Revenue are not authorized to grant extensions of more than thirty days, but the Commissioner of Internal Revenue has authority under the provisions of Section 14 (c) of the Act of September 8, 1916, to grant a reasonable extension beyond thirty days in meritorious cases. If you desire an extension of more than thirty days your request should be addressed to the Commissioner and should contain a detailed statement covering the reasons which make it impossible for you to file your return on or before March 1.

6. Would a Personal Return Rendered by an Agent, for and in My Behalf, be Accepted?

If by reason of illness, absence, or non-residence, a taxpayer is unable personally to render his return, he may appoint an agent to act for him, and the return executed by the agent will be accepted if he makes affidavit that he has sufficient knowledge to make a complete and accurate return for his principal, and assumes responsibility for making the return and incurring the penalties provided for a delinquent, erroneous, false or fraudulent return.

7. What Would Happen Should a Taxpayer Render a False or Fraudulent Return with Intent to Evade a Proper Payment of Income Tax?

Under the provisions of Section 3176, Revised Statutes, he would become liable to an additional tax of 100%, and under the provisions of Section 18 of the Act of September 8, 1916, as amended, to a fine of not to exceed \$2,000, or to one year's imprisonment, or both, in the discretion of the court and to the costs of prosecution.

8. May a Husband and Wife, Living Together, and Each Receiving an Independent Income, Render Separate Returns?

Yes. If the husband and wife each receive an independent income equal to or in excess of \$1,000, separate returns may be rendered. If, however, the income of either is less than \$1,000, but their combined income equals or exceeds \$2,000, a joint return should be rendered.

9. If a Husband and Wife Render a Joint Return, is the Additional Tax Assessed Against That Return Based upon the Aggregate Amount of Income Shown?

No. The normal income tax will be assessed against the aggregate amount reported by the husband and wife whether a joint or separate return is rendered, but the additional income taxes are only assessed against the separate income of each.

10. *Is a Married Man Entitled to a Personal Exemption of \$2,000 and \$400 Additional Exemption on Account of Two Dependent Children, Whose Total Net Income Does not Exceed \$2,400 but Does Equal or Exceed \$2,000, Required to Render a Return?*

Yes. While he will not be required to pay an income tax, he is required to render a return if his net income equals or exceeds \$2,000.

11. *If an Individual Engaged in Business Takes an Inventory and Closes His Books on any Day During a Calendar Year, Can He Render His Personal Income Tax Return on the Basis of That Fiscal Year?*

No. A personal income tax return cannot be rendered for any other period than a full calendar year.

12. *Where Can I Get the Blank Form upon Which to Render My Return?*

From the Collector of Internal Revenue for your District. The Collector will endeavor to have such forms sent to you, but failing to receive one will not excuse you from making a return. If you do not receive one it is your duty to request the Collector to furnish you with a copy.

RATE OF TAX

13. *What Personal Income Taxes Are Imposed Upon Income Received During the Calendar Year 1917?*

In computing income tax liability for the year 1917, the normal and additional income taxes imposed by the Act of September 8, 1916, and also the Act of October 3, 1917, are to be considered.

Under Section 1 (a) of the former Act a normal income tax of 2% is imposed upon so much of an individual's net income, exclusive of that derived from dividends on the capital stock, or from the net earnings of corporations, joint-stock companies, etc., subject to like tax, as exceeds the amount of personal exemption to which he is entitled under Section 7; and so much of his total net income, including that derived from dividends and net earnings of corporations, as exceeds \$20,000, is subject to the additional income tax at the graduated rates prescribed by Section 1 (b).

Under Section 1 of the Act of October 3, 1917, so much of the individual's net income, exclusive of dividends, etc., as exceeds the amount of personal exemption allowed by Section 3, is subject to an additional normal tax of 2%, and that portion of his total net income, including dividends, as exceeds \$5,000, is subject to the additional income tax, at the graduated rates specified in Section 2, Act of October 3, 1917.

EXEMPTION

14. *What Amount of Personal Exemption is Allowed by Each of the Two Acts?*

Section 7 of the Act of September 8, 1916, allows a personal exemption of \$3,000 to unmarried persons, plus \$1,000 additional if the person making the return be the head of a family or a married man with a wife living with him. This additional exemption of \$1,000 is allowed if the person making the return is a married woman with a husband living with her, but in no event shall this additional \$1,000 be deducted by both husband and wife.

The exemptions allowed by Section 3 of the Act of October 3, 1917, are the same as under the Act of September 8, 1916, except that the exemptions of \$3,000 and \$4,000 allowed by the 1916 Act are, respectively, \$1,000 and \$2,000.

In addition, a further exemption of \$200 is allowed for each dependent child under eighteen years of age, or over that age if incapable of self-support because mentally or physically defective, and this is allowed in computing normal tax liability under both Acts.

15. *What is Meant by the Term "Head of a Family"?*

Treasury Decision 2427 states that a "head of a family" is held to be a person who actually supports and maintains one or more individuals who are closely connected with him by blood relationship, relationship by marriage or adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation.

INCOME, GROSS AND NET

16. *What Income, if any, is Exempt?*

(a) The proceeds of life insurance policies paid to individual beneficiaries upon the death of the insured.

(b) The amount received by the insured, as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term, or at the maturity, or surrender, of the insurance contract.

(c) The value of property acquired by gift, bequest, devise or descent. It must be understood, however, that the income derived from such property is taxable.

(d) Interest upon the obligations of a State, or any political subdivision of a State, or upon the obligations of the United States, except in the case of obligations of the United States issued after September 1, 1917, only to the extent provided in the Act authorizing their issue.

(e) Interest upon the obligations of any possession of the United States, or securities issued under the provisions of the Federal Farm Loan Act of July 17, 1917.

(f) The compensation of the present President of the United States during the term for which he has been elected, and the judges of the Supreme and inferior courts of the United States in office on October 3, 1917.

(g) The compensation of all officers and employes of a State or any political subdivision of a State, except when such compensation is paid by the United States Government. This includes the official salaries received by public school teachers, State and county officers and employes of municipalities; but income derived by such persons from sources other than State, county or municipal funds, and the other sources enumerated in this answer, is taxable. (See Section 4, Act of September 8, 1916, as amended.)

INCOME

17. *What is Meant by the Term "Net Income"?*

For the purpose of determining whether or not a personal income tax should be rendered, Net Income means your total net income less the exemptions specified in the answer to the 16th question and the general deductions specified in the answer to the 45th question.

18. *In rendering a return, what items of income must I report under gross income?*

Under Gross Income should be reported every item of income derived from any source whatever (except those specified in the answer to Question 16, actually received during the calendar year for which the return is rendered, whether received in cash or the equivalent of cash, including:

(a) All amounts of salary, wages, commissions or compensation of whatever kind, received for personal service, including professional fees.

(b) All amounts of gain, profit or income derived from a business, trade, commerce, or from any sale of property, real, personal or mixed. The method of ascertaining the amount of gain or profit derived from a sale is outlined in the answer to Question 23.

(c) Rents, interest on notes, mortgages, deeds of trust, or other securities issued by individuals, partnerships, etc., interest on bonds, mortgages, deeds of trust, or other similar obligations of corporations, joint-stock companies, associations or insurance companies, and interest on bank deposits.

(d) All income received from fiduciaries, that is, amounts received from incomes of estates, trusts, etc., through trustees, administrators or executors.

(e) If you have an interest in a partnership you should report your distributive share of the earnings or profits of the partnership ascertained during the calendar year for which the return is rendered, whether distributed to you or not. That is, if the fiscal year of the partnership ends on December 31 of that year, your distributive share of its earnings or profits ascertained upon the close of the books on December 31 should be returned. If the partnership ends its fiscal year on some day during the calendar year, your distributive share of its earnings or profits ascertained at that time should be reported.

(f) All items of foreign income, that is, interest upon bonds and mortgages, or deeds of trust, or other similar obligations issued by individuals who are citizens or residents of foreign countries, foreign corporations, joint-stock companies, etc.

(g) Royalties from mines, oil and gas wells, patents, copyrights, franchises, or other legalized privileges.

(h) Dividends on stock, or from the net earnings of domestic corporations, joint-stock companies, associations or insurance companies, whether paid in cash, stock or script. As the net earnings of corporations, joint-stock companies, etc., are subject to the tax imposed upon the net income of corporations, dividends from such net earnings are not subject to the normal income tax in the hands of the shareholders receiving the same; but they are to be returned for the additional tax purposes and are subject to that tax. The rates of tax to be assessed against a dividend received during the year 1917, or any subsequent year, are covered by the answer to Question 43.

19. *If my salary for December, 1917, is not paid to me until some day in January, 1918, or later, is its amount to be included in my 1917 return?*

It is to be returned for the year during which it was actually received by you.

20. *"A" is employed by a corporation at an annual salary of \$3,000. The corporation, being in financial straits, only paid "A" \$2,000 during each of the years 1915 and 1916. In 1917, "A" received his salary in full plus the balance of the salary due him for the two previous years. Must he include the full amount received in 1917 in his return for that year?*

Yes. \$5,000 should be returned and that amount will be subject to income tax at the rates prescribed for the year 1917.

21. *If an employer agrees to pay an employe a certain stipulated salary and furnish him with room and board, are the latter items to be considered in computing income tax liability?*

Yes. A fair rental value is to be placed upon the room and a fair value upon the meals furnished, and their amounts reported as income by the employe. If the services of the employe are used in the employer's business or trade, the latter may claim the rent paid by him for the room, if any, and the actual cost of the meals so furnished as a deduction under the head of Business Expenses.

22. *If I enter into a contract in 1917 which will not be completed until 1918, and which requires me to make expenditures for material and labor, provide for possible losses, etc., must I include the advance payments I receive in 1917 in my return for that year?*

No. As you are unable to determine what amount of gain or profit you will derive from the contract until it is completed, the payments re-

ceived thereon during 1917 need not be included in your return for that year. When the contract is completed the net gain or profit derived therefrom should be reported under Gross Income in your return rendered for the year 1918.

23. *How am I to determine what amount of gain or profit derived from a sale of property is returnable for income tax purposes?*

If you acquired the property sold prior to March 1, 1913, you should take its fair market price or value as of that date and add thereto all amounts subsequently expended in making permanent improvements, and the difference between the total thus obtained and the selling price of the property is the amount to be reported under Gross Income.

If you purchased the property on or after March 1, 1913, the difference between its cost, plus all amounts subsequently expended for permanent improvements, and its selling price, is to be returned.

If the property came to you on or after March 1, 1913, as an inheritance, the difference between the appraised value placed upon it at that time plus all amounts subsequently expended for permanent improvements, and its selling price, is to be returned.

24. *When is a farmer to return for tax purposes the value of crops and stock produced?*

The value of grain, stock and other products produced on a farm is not considered taxable income until reduced to cash or the equivalent of cash. Therefore, if crops and stock were produced in 1916 on a farm owned by you and they were sold in 1917, the total amount received therefor is to be included under Gross Income in your 1917 return. Crops and stock produced in 1917, and on hand December 31 of that year, need not be considered; but the amount received therefor should be included in your return rendered for the year during which they are sold.

25. *I rent a farm on shares. When is my share of the crops and stock to be taken into consideration?*

Only for the year in which sold.

26. *Is a farmer required to report the value of the farm produce which is consumed by himself and family?*

No, but any amount of expense incurred in producing garden truck, or other products so consumed, cannot be claimed as a deduction.

27. *If a farmer exchanges produce for merchandise, groceries, etc., is the value of such merchandise to be returned for tax purposes?*

Yes. The price placed by the merchant upon the goods exchanged for farm produce is to be included as income in the farmer's return.

28. *A tenant, under the terms of a lease, is required to pay a cer-*

tain cash rental and in addition make certain improvements. Is the cost of these improvements held to be taxable income to the property owner?

Yes, the cash rental, plus cost of improvements, should be reported under gross income in the landlord's personal return.

29. *Special payments, designated as "bonuses," are often made to officers and employees of corporations, firms and individuals. Are such items of income subject to tax in the hands of their recipients?*

Any bonus, or other item of compensation, paid to an employee in addition to his regular salary or wage under a contract expressed or implied, as additional compensation for services rendered, as a reward for past endeavors, or as a stimulus to further zeal and enthusiasm in the discharge of his duties, is held to constitute taxable income which should be reported under Gross Income in the employee's return rendered for the year during which received. Christmas remembrances, anniversary gifts, etc., from an employer to an employee do not constitute such items as are subject to the income tax.

30. *Is an individual contractor who constructs a public highway, a bridge, a drainage system, etc., for a State, County, or a Municipality, held to be an employee of the political subdivision for which the work is performed?*

No, and therefore, the income derived from his contract is not exempt from the Federal income tax.

31. *What method should a merchant adopt to ascertain the amount of gain or profit which is to be reported under gross income?*

Any individual who conducts a grocery, dry-goods, clothing, or farm-implement business, or any other business which requires that a stock be carried, should take an inventory at the close of each calendar year, the goods then on hand being inventoried at their cost price. To the total of his inventory taken at the beginning of the year for which the return is to be rendered should be added the cost of all goods purchased during that year, and the difference between the amount thus obtained and the total of his inventory taken at the close of the tax year, plus his total gross receipts, is the amount to be reported under Gross Income. Gross receipts should not be reported under Gross Income and the cost of the goods purchased, claimed as a deduction.

32. *A piano dealer sells an instrument under a contract which states that payment therefor is to be made in monthly installments, and that the title to the instrument is to remain with the dealer until the last payment is made. How is the latter to report the amount of profit derived from this transaction?*

It is held that every dollar received under such a contract represents, in part, the return of a portion of the cost of the article to the dealer and a portion of the profit to be derived from the transaction; and that the amount of profit represented by all payments during the

tax year should be included in the dealer's personal return rendered for that year. For example, a piano which cost the dealer \$300 is transferred to another under a contract calling for twenty monthly payments of \$20 each, a total of \$400. Each monthly payment represents a return of capital amounting to \$15 and a profit amounting to \$5.00, and multiplying this latter amount by the number of payments received during the year yields the amount to be returned as income for that year. When there is a lapse or default in payment and the dealer becomes repossessed of the article, the entire amount theretofore paid and credited to principal from date of contract to date of default is income to be included in a return of income, for the reason that it is held that such an amount constitutes rental for the use of the article. In case of such a default a reasonable allowance may be claimed as a deduction to cover such depreciation as may have actually occurred in the value of the repossessed article by reason of its use.

33. *I have two children who live at home and are regularly employed. One is 17 years old; the other, 21 years old. Am I required to include the amount of income which accrues to each during a calendar year in my own personal return?*

As the first child has not reached its majority and is still legally under your control, the amount of its income is to be included in your personal return and is subject to tax in your hands. The income of the child which has attained its majority is not to be included in your return and is only subject to tax in the hands of that child.

34. *Must I include in my personal return the amount of interest I receive on Liberty Loan Bonds, or is that interest exempt from tax?*

All interest derived from the Liberty Loan 3½% Bonds issued under the Act of April 24, 1917, is exempt from both the normal and additional income tax.

Interest derived from the Liberty Loan 4% Bonds, issued under the Act of September 24, 1917, is exempt from the normal income tax; but so much of the interest as is derived from such bonds, the principal of which exceeds \$5,000, is subject to the additional income tax. That is, if you hold \$8,000 of Liberty Loan 4% Bonds the interest from \$5,000, or \$200, is exempt from tax, and the balance of the interest, or \$120, is subject to the additional tax.

35. *I held an endowment life insurance policy upon which I paid premiums for twenty years. In 1917, that contract matured and I received its face value, or \$1,000. Must I return the entire amount received?*

No. Return only the difference between the aggregate amount of premium paid and the amount received upon maturity of the contract.

36. *"A," who is the employe of a corporation, was injured and under the laws of the State in which the accident occurred he received*

\$5,000 on account of the injury he suffered. Must the amount thus received be reported as income?

Yes. Any amount received under an Employers' Liability Act or any other similar Act, or as the result of a settlement or compromise for "pain and suffering," is held to be such income as is subject to the Federal income tax. This ruling is also applicable to any amount received under the terms of an accident insurance policy.

37. I purchased a six per cent. \$100.00 coupon bond at its face value, plus \$1.50, that is, three months accrued interest. Three months later I detached a coupon therefrom and collected \$3.00 interest. Must the entire amount of interest received be returned as income?

No. Report only so much interest as accrued after the date of your purchase. It is the seller's duty to report the balance.

38. Do the Pensions and Retired Pay of Ex-Officers and Men of the United States Military and Naval Forces Constitute Items of Taxable Income?

Yes.

39. I Own Stock in a Bank Which, Under a State Law, Is Required to Pay the Taxes Assessed Against Such Stock. How Is This Matter to be Handled for Income Tax Purposes?

The proportionate part of the entire amount of taxes so paid by the bank, which is properly chargeable against the number of shares held by you, should be reported, for additional tax purposes, in your personal return, as a dividend, and then claimed as a deduction under the heading of TAXES.

DIVIDENDS

40. The Net Earnings of a Corporation in Which I Held Stock in the Year 1916 Amounted to \$50,000, Which Amount Was Carried to Surplus Account. Its Net Earnings from January 1 to September 1, 1917, Amounted to \$70,000, and on this Latter Date These Last Earnings Were Carried to Surplus and a Cash Dividend of \$50,000 Declared and Soon Thereafter Paid. What Income Taxes Are to be Assessed Against this Dividend?

Section 31 (b) of the Act of September 8, 1916, as amended by the War Revenue Act, provides, in part, as follows:

"Any distribution made to the shareholders or members of a corporation, joint-stock company or association or insurance company, in the year 1917, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association or insurance company."

Therefore, the dividend to which you refer is to be charged against the most recently accumulated earnings or surplus; that is, against the \$70,000 earned during 1917 and carried to surplus on the day the dividend was declared, and it will be subject to the additional tax at the rates prescribed by the Act of September 8, 1916, and also, at the rates prescribed by the War Revenue Act of October 3, 1917.

41. *Suppose That Instead of Declaring a Dividend of \$50,000, this Corporation had Declared a Dividend of \$100,000?*

If such had been the case, the entire amount of net earnings carried to surplus on September 1, 1917, would have been subject to additional tax at the same rates as the dividend mentioned in your inquiry, next above, and the balance, or \$30,000, would have been held to have been paid from the 1916 earnings, and would have been subject to additional tax only at the rates prescribed in the Act of September 8, 1916.

42. *Assuming that Instead of Paying this Dividend in Cash a Corporation had Capitalized the Same Amount of Surplus as was Distributed in Cash, or \$100,000, and Issued the New Stock to its Shareholders as a Dividend. Would this Dividend be Taxable?*

Yes, just the same as though it had been paid in cash.

43. *A Corporation Began Business January 1, 1912, its Net Earnings were as Follows:*

January 1, 1912, to March 1, 1913.....	\$10,765
March 1, 1913, to January 1, 1914	5,220
For the Year 1914	7,347
For the Year 1915	11,000
For the Year 1916	15,300
January 1 to September 1, 1917	27,400

Amount of Surplus on Hand September 1, 1917.... \$77,032

The Corporation Never Paid a Dividend Until September 1, 1917, on Which Date It Declared and Paid a Dividend of \$77,032. How Will this Dividend be Taxed?

That portion of the dividend which represents the distribution of 1917 earnings, or \$27,400, will be subject to the additional tax at the rates prescribed in the Act of September 8, 1916, and, also, in the War Revenue Act of October 3, 1917; and that portion which represents 1916 earnings, or \$15,300, at the rates prescribed in the Act of September 8, 1916, only; that portion which represents earnings which accrued from March 1, 1913, to January 1, 1916, at the rates of additional tax prescribed in the Act of October 3, 1913. The remainder, or \$10,765, is exempt from tax under that portion of Section 31 (b) which states that:

“But nothing herein shall be construed as taxing any earnings or profits accrued prior to March 1, 1913, but such earnings or profits may be distributed in stock dividends or otherwise, exempt

from the tax, after the distribution of earnings and profits accrued since March 1, 1913, has been made."

43½. *Will It Be the Taxpayer's Duty to Advise Himself What Proportion of a Dividend Received by Him is Properly Chargeable, under Section 31 (b), Act of September 8, 1916, as Amended, to the Corporate Earnings or Profits for Each Tax Year?*

Yes.

44. *Assuming that a Corporation had Assets Which had Greatly Appreciated in Value and had Carried the Amount of that Appreciation to its Surplus Account and Capitalized Same, or that it Capitalized its Good Will, and then Issued the New Stock to its Shareholders as a Dividend. Would this Dividend be Subject to Tax?*

Only such dividends as represent a distribution of earnings or profits accrued since March 1, 1913, are subject to the additional tax when received by the shareholders. As appreciation estimated to have occurred in the value of the assets held, and good will, do not represent actual earnings, profits or income, a dividend based upon a capitalization of any such items is not subject to tax when received by the shareholders. It should be understood, however, that when any of the stock received in payment of such a dividend is sold, the entire proceeds derived from the same are to be returned under GROSS INCOME in the shareholders' return rendered for the year during which the sale is made, and will be subject to both the normal and additional income taxes.

45. *In Rendering a Personal Return, What Items May I Claim as Deductions?*

See Section 5 of the Act of September 8, 1916, as amended by the War Revenue Act.

GENERAL DEDUCTIONS

46. *What Constitutes an Item Allowable as a Deduction under the Head of Business Expenses?*

All amounts of expenses actually paid during the tax year in the conduct of a business, trade or profession.

This includes all amounts actually paid by a farmer for labor in preparing his land for a crop and the cultivation, harvesting and marketing of the crop, the cost of the seed and fertilizer used, the amounts expended for labor used in caring for live stock and the cost of the feed, the cost of the stock purchased for the purpose of resale. (It should be understood, however, that if such cost is claimed as a deduction, the entire proceeds received upon a sale of the stock is to be returned as income.) The amounts actually paid in making repairs to farm buildings, but not the dwelling house, repairs to fences, farm machinery, etc., the cost of materials for immediate use and farm tools which are used up in the course of a year or two, such as binding twine, stock powders pitch

forks, spades, etc., and the amount of rent paid for a farm may also be claimed. The amounts paid for live stock which is to be used for breeding purposes are held to represent investment of capital and are not allowable as deductions.

A merchant may claim as deductions the amounts paid for advertising, hire of clerks and other employees, the cost of the light, fuel, water, telephones, etc., used in or at his place of business, drayage and freight bills, the cost of operating delivery wagons, trucks, and the repairs to same.

The cost of goods purchased for resale is not to be claimed as a deduction as a credit for that cost may be obtained by following the method of computation outlined in the answer to the 31st question.

A physician may claim as deductions the cost of medicines and medical supplies used by him in the practice of his profession, expenses paid in the operation and repair of an automobile used in making professional calls, dues to medical societies and subscriptions to medical journals, the expenses of attending medical conventions, the rent paid for office rooms and the hire of office assistants, the cost of the fuel, light, water, telephone, etc., used in such office rooms. Amounts expended for books, medical supplies and surgical instruments of a permanent character are not allowable as deductions.

This, in a general way, outlines the ordinary and usual expenses incurred by a farmer, a merchant or a professional man, which may be claimed as deductions, and the principles underlying these allowances are equally applicable in the case of any one engaged in a business, trade or profession. In short, all expenses connected directly and solely with the conduct of an income-producing business, trade, profession or vocation, are allowable.

Items of personal expense or items connected in any way with the support, maintenance and well-being of a family are not allowed; neither are the amounts paid for tools, implements, vehicles, machinery, or surgical instruments which are more or less permanent in character, nor the cost of medical, law or other professional books, nor amounts expended in making permanent improvements or betterments of any kind whatsoever, allowable as deductions. These latter items are held to be investments of capital upon which depreciation may be claimed.

47. I Employ a Man to Assist Me in Operating My Farm and a Woman to Assist About the House. Is the Compensation Paid to Each Allowable as a Deduction?

Unquestionably, as the amount paid to the male employee, but a line must be drawn as to the amount paid to the female employee. If her time is employed entirely in taking care of milk and cream produced for sale, in the production of butter, cheese, etc., the care of milk cans and churns, or, if a separate table is maintained for laborers employed on the farm and her services are used entirely in the preparation and serving of the meals furnished the laborers and in caring for their rooms, the compensation paid her constitutes an allowable deduction. If, however,

she is employed to assist in caring for the farmer's own household, no deduction can be claimed.

48. *If I Employ a Minor Son or Daughter to Assist Me in My Business or Trade and I Pay a Salary or Wage for Such Assistance, May I Claim the Amount as a Deduction?*

No. If, however, the son or daughter has attained his or her majority, the amount of compensation paid for his or her services may be so claimed.

49. *Can a Taxpayer Claim a Deduction for His Own Remuneration?*

Wages or salary drawn by a taxpayer from his own business are more in the nature of a charge out of profits than a charge against profits. If such could be deducted they would merely be added to his income, the effect of which would be to take money out of one pocket and put it in another. Therefore, no deduction can be claimed.

50. *Can the amounts expended by a business man in entertaining out-of-town customers, or prospective customers, be claimed as deductions?*

Yes. If the sole purpose of the business man in making such expenditures is to cultivate the good will of his customers and secure an increase in trade they may be so claimed.

51. *Can a salesman working on a commission basis claim as deductions the amounts expended from his own funds for railroad fare, excess baggage, taxicab or street-car fare, show rooms, assistants, advertising, etc.?*

Yes. If he is not reimbursed for such expenditures by his firm, he should report under Gross Income the total amount of commissions received and he may then claim such expenses as were actually incurred and paid in the earning of those commissions.

52. *"A," who is employed in a city, has his home in a suburb. He pays carfare between his home and place of employment and takes his noon lunch in the city. Can the amounts expended for carfare and lunch be claimed as a business expense?*

No, as such amounts are held to be items of personal expense.

53. *Are the items of expense incurred and paid by me during the calendar year in connection with a farm which I lease to another on a cash or crop-share rental basis, such as repairs to fences, farm buildings, etc., allowable as deductions?*

Yes.

54. *Can the amount of life insurance premiums and premiums paid for insurance on my residence property be claimed as deductions?*

No, as these are held to be items of personal expense. If, however, you pay premiums on insurance policies covering farm buildings, other than your dwelling house, or on any property used for business purposes, these premiums are allowable as deductions.

55. *A tenant, under the terms of a lease, is obligated to pay a certain cash rental and all taxes assessed against the property and keep it insured. May he claim as a business expense the aggregate amount of rental, taxes, and insurance premiums paid?*

Yes, if the property is used by the tenant for business or trade purposes and not as a home, the aggregate amount may be claimed as a deduction for the year during which actually paid.

56. *I own stock in a corporation which, in 1917, assessed each of its stockholders \$50 on each share held. Can the amount paid by me be claimed as a deduction?*

No. Assessments made by a corporation on its capital stock are regarded as further investments of capital and do not constitute an allowable deduction in the return of the individual.

57. *If a physician, or other professional or business man, rents a home and uses a portion of same for professional or business purposes, may any portion of the rent paid for that home be claimed as a business expense?*

Yes. The proportion of the rent paid which is properly chargeable to the number of rooms so used may be claimed as a deduction.

58. *In 1917 I purchased a property, the title to which proved defective, and in order to straighten the matter out I employed an attorney and resorted to court proceedings. Can I claim a deduction to cover the fee paid the attorney and the court cost?*

No. Such items are held to be a part of the cost of the property and, therefore, not allowable as deductions.

59. *You have heretofore stated that only such items of income as have actually been paid to me during the tax year are to be reported, and only such items of expense as I have actually paid during that year claimed as deductions. Cannot a business or professional man who keeps a set of books and enters thereon as income the cost of goods sold on credit, or fees earned but not paid, and charges to expense account items which have not been paid by him, report his net income for the year as shown by his books when they are balanced at the end of the calendar year?*

Section 8 (g) of the Act of September 8, 1916, states that:

"An individual keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect his income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of

the Secretary of the Treasury, make his return upon the basis upon which his accounts are kept, in which case the tax shall be computed upon his income as so returned."

It should be understood, however, that if a business man, who keeps a set of books, wishes to render his returns upon the book basis, he must at no time inventory any assets at other than its actual cost to him.

60. *What is meant by the statement in the law that all interest paid within the year upon the indebtedness of a taxpayer, "Except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title" may be claimed as a deduction?*

If a taxpayer, desiring to do his patriotic duty, borrowed money to invest in Liberty Loan 3½% Bonds, or if he borrowed money to invest in the bonds of a State, county or municipality, or any security issued under the provisions of the Federal Farm Loan Act of July 17, 1917, or any other securities the interest from which is not subject to income tax as explained in the answer to the 16th question, the interest paid by the taxpayer upon the money so borrowed cannot be claimed as a deduction: with this exception, all interest paid within the year may be so claimed.

61. *If I have a certain sum of money invested in a farm or business, may I claim as a deduction, under the head of interest, an estimated amount of interest which might have accrued to me had that money been deposited in a bank or invested in interest-paying securities?*

No.

62. *What forms of taxes cannot be claimed as deductions?*

Taxes assessed against an individual on property owned by him to pay for the paving of a street contiguous to his property, the construction of a sewer, sidewalk, etc., the sprinkling or oiling of a street in front of his home, the construction of levees to protect, or ditches to drain, property owned by him, cannot be claimed as deductions. In short, such taxes as are not general in nature and are levied on account of some work or privilege the benefit of which accrues to a limited number of property owners, of which the taxpayer is one, are not allowable deductions.

63. *If I pay any amount of personal income tax for the year 1917, may I claim that amount as a deduction for the year 1918?*

No. The Income Tax Law states that income taxes are not allowable as deductions.

64. *In 1916 I bought certain stocks and bonds for \$5,000 and in 1917 the value of these securities dropped to \$4,000. May I claim the difference of \$1,000 as a loss in computing my income tax liability?*

No. Under the provisions of the fourth and fifth paragraphs of Section 5 of the Act of September 8, 1916, quoted in the answer to the

45th question, only such losses as have actually been sustained during the year can be claimed; that is, the loss must have resulted from a completed and closed transaction. In your case you still own the securities. They may go up in value during 1918, and until they are sold or otherwise disposed of you are unable to determine whether you will suffer a loss or derive a gain from your investment. In other words, no account is to be taken, for income tax purposes, of fluctuations in the market value or arbitrary changes in the book value of securities or other property.

65. *John Doe, while driving an automobile, ran down and injured another person. He either paid over a certain sum, or paid a judgment rendered against him, in settlement of the injury done. Can he claim the amount so paid as a loss?*

No. It was not a loss which was incurred in the conduct of his business or trade, or which resulted from a transaction entered into for profit.

66. *How am I to determine what amount of loss, resulting from a sale of property, is allowable as a deduction?*

The same method of computation should be followed as is outlined in the answer to the 23rd question. If the result is a loss instead of a gain, that loss may be claimed as a deduction, if it was connected with your regular business or trade, or during the same year you derived gains from other transactions entered into for profit but not connected with your regular business or trade in excess of the amount of your loss.

67. *What is the difference between the losses allowable as deductions under the provisions of the fourth paragraph of Section 5 of the Act of September 8, 1916, and those allowable under the provisions of the fifth paragraph, same section?*

Losses, for income tax purposes, are divided into two classes: (a) those incurred in business or trade and (b) those resulting from transactions entered into for profit but not connected with the taxpayer's regular business or trade.

For example: "A" is regularly engaged in buying improved or unimproved real property with the intention of selling the same as early as possible at a profit. In one or more instances the property purchased may be sold at a loss, and that loss may be claimed by him as a deduction under the provisions of the fourth paragraph for the reason that he is regularly engaged in buying and selling real estate. Now, "B" buys a home or, perhaps, he buys two or three pieces of property in the course of several years. He is not regularly engaged in buying and selling real estate and, therefore any loss he may suffer through such a transaction can only be claimed by him as a deduction under the provisions of the fifth paragraph of Section 5; that is, only so much of his losses as does not exceed the amount of gain or profit derived during the same year from other transactions entered into for profit but not connected with his

regular business or trade can be claimed. If "B," in 1917, sold one property at a loss of \$2,000 and another property at a gain of \$1,000, he must report the gain of \$1,000 under Gross Income; and can claim only that amount as a loss.

This same rule is applicable in the case of losses arising from purchases and sales of stocks and bonds. If the taxpayer is regularly engaged in buying and selling such securities any loss he may suffer may be claimed under the provisions of the fourth paragraph. If he is not so engaged it may only be claimed under the provisions of the fifth paragraph.

68. *In computing amount of profit or loss resulting from purchase and sale of securities which is to be returned or claimed as a deduction, under the provisions of the fifth paragraph of Section 5 of the Act of September 8, 1916, is income or dividends received on the securities during the tax year to be taken into consideration?*

No. Interest and dividends are held to be items of current income, returnable as such, and they are not to be considered when computing the amount of profit or loss which results from a purchase and sale.

69. *A professional man or a merchant owns and operates a "Fancy Stock Farm." The expenses of operation exceed the gross receipts. Can the difference be claimed as a deduction under the head of losses?*

No. It is held that where a farm is operated for purposes of recreation or pleasure, and not primarily for profit, but as a hobby, that farm is not to be classed as a commercial enterprise, that it does not form a part of its owner's business or trade and until it is placed upon a profit-paying basis the gross receipts are not to be reported under Gross Income and the expenses are not to be claimed as a deduction. This ruling, of course, precludes the claiming of the difference between the two amounts as a loss.

70. *Suppose I Buy a Farm Which Is Much Run Down, With the Intention of Making it a Profit-Paying Property. To Do this I am Obligated to Expend Large Amounts for Labor in Clearing Away Brush, for Fertilizer, Lime, etc., and for Several Years the Expenses Will Greatly Exceed the Gross Receipts. Can the Excess of Expenses over Receipts for Each Year Be Claimed as a Loss?*

No. The amounts so expended are held to be investments of capital, the result of which is an improvement or betterment, and, until the farm becomes a paying proposition no portion of the gross receipts is to be reported as income and no portion of the expenses can be claimed as a deduction, either under the head of Business Expenses or under the head of Losses.

This same ruling is equally applicable in the case of a young orchard. If, after the farm or orchard has been placed upon a profit-paying basis a bad year follows and a loss is sustained during that year, that loss may be claimed as a deduction.

71. *If Cattle or Other Live Stock are Produced on a Farm which I own or Operate, and are Then Lost Through Disease, May I Claim Their Value at the Time of Death as an Allowable Deduction?*

No. If the stock which died was purchased and the cost has not been claimed in a previous return as a deduction, that cost may be claimed as a deduction in your return rendered for the year during which the loss occurred.

72. *If a Crop which is Ready to be Harvested but Has Not Been Gathered, or a Crop Which Has Been Harvested But Has Not Been Sold, is Destroyed by Storm, Flood or Fire, can the Value of that Crop be Claimed as a Deduction?*

No. It is understood, of course, that the actual cost of producing or harvesting a crop which has been so destroyed may be claimed as a deduction under the head of Business Expense.

73. *What Conditions are Necessary in Order that a Debt May Be Claimed as a Deduction?*

It must be (a) a bona fide debt, (b) definitely ascertained to be worthless and uncollectible during the year for which the deduction is claimed, and (c) if books are kept it must be charged off within the year for which the deduction is claimed and no longer considered an asset or carried as such on the books.

74. *In 1917 a Corporation, or a Firm to Which I had Loaned Money Became Bankrupt. Can this Debt Be Considered Absolutely Worthless and Claimed as a Deduction for 1917?*

No, unless the affairs of the debtor have been finally adjusted, its assets sold for the benefit of, or distributed to, its creditors, and its receiver in bankruptcy discharged. If all this has occurred during the year 1917 so much of the debt as remains unpaid after the receiver is discharged may be claimed as a deduction for the year 1917.

75. *Is It Absolutely Necessary that the Debtor Corporation, or Firm, Mentioned in the 74th Inquiry, Be Declared a Bankrupt and its Receiver Discharged Before I Can Claim a Deduction on Account of the Debt in Question?*

No. If the debtor corporation has no assets whatsoever, and it is definitely known that nothing whatsoever can be collected from debtor itself or any person connected with it, a creditor need not go to the expense of instituting bankruptcy proceedings in order to establish his right to claim the worthless debt as a deduction.

76. *"A" Endorses a Note for "B." The Latter has Since Departed for Parts Unknown and the Note Became Due in 1917, and "A" Was Required to Make Good His Endorsement. Can He Now Claim as a Deduction the Amount Paid by Him to the Creditor?*

Yes. If he has no knowledge of "B's" present whereabouts and has

good reason to believe that he is possessed of no assets and that it is his intention never to make payment of it, the amount so paid by "A" may be considered a bad debt due him from "B."

77. If, on Account of Friendship, or Relationship, I Advanced a Certain Sum to Assist a Needy Friend, or Relative, and at the Time Such Advance Was Made I Had Little or no Reason to Expect that the Amount so Advanced Would Ever be Returned, May I Now Claim a Deduction to Cover Such Advance?

No. Such an advance, partaking, as it does, somewhat of the nature of a philanthropic donation or a good will offering, is not held to constitute a bona fide debt.

78. In Rendering My 1914 Return I Claimed a Deduction to Cover a Debt I Then Believed to be Absolutely Worthless. In 1917 the Debtor Has Discharged Part of His Obligations. How Should I Treat this Payment for Income Tax Purposes?

Consider it as an item of income and include this amount under Gross Income in your 1917 return.

79. A Professional Man Earned a Fee in 1916. As He Keeps no Books He Reports His Income for Tax Purposes on an Actual Receipt Basis. As this Fee Has Never Been Reported as Income, Can It Be Claimed as a Deduction, if Collection Cannot be Made?

No, never having been returned as income it cannot be claimed as a deduction.

DEPRECIATION

80. At What Rates May Depreciation Be Claimed and Under What Conditions?

As the rate at which depreciation may be claimed is dependent, in a greater or less extent, upon local conditions, the use to which the property is put, and its probable lifetime under normal business conditions, no specific rates at which it may be claimed have ever been established. The Law states that a "reasonable allowance" may be claimed and it is for the taxpayer to determine what constitutes a "reasonable allowance." To compute the amount which may be claimed, a taxpayer should determine the probable lifetime of the property, then divide its cost to him by the number of years it will be usable in a business in which employed, and the result thus obtained will represent the amount which may be claimed each year as a deduction, e. g., a frame building, the probable lifetime of which, without repair or replacement, is 25 years, cost \$5,000. Divide \$5,000 by 25, and claim \$200 each year as depreciation.

While each taxpayer must determine the probable lifetime of his property without regard to the following figures, it has been estimated that the average usable lifetime of a frame building is 25 years, a brick building 35 years; a stone building or a steel and concrete building, 50

to 100 years. The estimated lifetime of ordinary machinery is ten years, that of automobiles used for business or farm purposes and farm tractors, four to five years.

If a taxpayer wishes to claim the full amount of depreciation estimated to have occurred in the value of a building, or other property, used for business or trade purposes, he may do so, but this precludes his claiming a deduction to cover any amount expended during the same year in making repairs. If he wishes to claim a deduction on account of repairs, their cost must be deducted from the full amount of depreciation, and the balance may then be claimed as a deduction under the heading of Depreciation, that is, if the taxpayer expends \$100 in making repairs to a building which will depreciate in value \$200 during the calendar year, he may claim \$100 as business expense and \$100 as depreciation, or he may claim \$200 as depreciation and nothing for repairs. In short, the aggregate deductions claimed on account of repairs and depreciation must not exceed the full amount of depreciation estimated to have occurred.

In claiming depreciation the following fundamental principles must be taken into consideration:

(a) Only such depreciation as results from exhaustion, wear and tear of property, arising out of its use or employment in business or trade, can be claimed. Depreciation in the value of a home or any article of property, such as automobiles used for personal pleasure or convenience, cannot be claimed; the property must be used for the purpose of producing income.

(b) Depreciation other than that arising from wear and tear, such as a lessening of values due to changes in the social or business conditions in the neighborhood in which a property is located, changes of street grade, or fluctuations in market values, etc., cannot be claimed.

(c) Depreciation in the value of land, whether improved or unimproved, due to erosion, exhaustion, or any other cause cannot be claimed.

(d) Where the value of a piece of machinery or any other asset is lessened by reason of the production of an improved machine or article, that depreciation cannot be claimed, as it does not result from exhaustion, wear and tear.

(e) Where, in the course of years, the owner of property has claimed its full cost as depreciation in his income tax returns, no further claim will be allowed.

81. *A Store, or Other Building, has Outlived its Usefulness: the Owner Tears it Down to Make Room for a Building of an Improved Type. Can the Value of the Old Building at the Time of Destruction be Claimed as Depreciation or as a Loss?*

No. Losses due to the voluntary removal or destruction of buildings, etc., incident to improvement are either a proper charge to the cost of new additions or to depreciation already provided, as the facts may indi-

cate, but in no case is it a proper deduction in determining net income. If, however, a building is destroyed prior to the close of its lifetime, as estimated for the purpose of making depreciation charges, that portion of its cost which is properly chargeable to the period it might have remained in a usable condition, may be considered a part of the cost of the new building when computing the amount of the gain or profit derived from a sale of the latter.

82. *If the Authorities of a Municipality Declare that a Building is Unsanitary, or Unsafe for the Purposes to Which Put, and its Destruction is Ordered, can the Losses Sustained by the Owner be Claimed as a Deduction?*

No, neither as a loss nor as depreciation.

83. *I Bought a Patent for \$5,000 which, Under the Patent Laws of the United States, Had Five Years Yet to Run. As the Value of this Patent Depreciates Each Year on Account of the Exhaustion of the Patent Period, May a Deduction Be Claimed?*

Yes. The cost of the patent, divided by the number of years it has yet to run, yields an amount which may be claimed each year as depreciation. In your case this amount is \$1,000.

84. *I understand that depreciation in the value of articles for personal use cannot be claimed as a deduction. However, as actors and actresses are often required to furnish their own wardrobes, does not the depreciation in the value of such property constitute an allowable deduction?*

If costumes purchased by members of the theatrical profession are used exclusively for the production of a play and are not adapted for occasional personal use, and are not so used, a deduction may be claimed on account of such depreciation in their value as occurs during the year on account of wear and tear arising from their use in the production of the play or from their becoming obsolete at the close of the production.

DEPLETION

85. *Under what conditions and at what rates may depletion due to the removal of a natural product from oil or gas wells, mines, quarries, etc., be claimed?*

Paragraph 8 of Section 5 of the Act of September 8, 1916, as amended by the War Revenue Act of October 3, 1917, states how the amount of depletion allowable as a deduction is to be ascertained, but as so many factors are to be considered in computing depletion an answer which will be applicable in all cases where depletion occurs cannot here be given. Such factors are covered in considerable detail by T. D's 2446 and 2447, copies of which may be obtained from the Collector of Internal Revenue for your district, and where these decisions do not afford all the

information necessary in your particular case, a detailed statement covering all the facts and figures in your case should be forwarded to the Collector, with a request for a ruling.

CONTRIBUTIONS AND GIFTS TO RELIGIOUS, CHARITABLE AND SCIENTIFIC ORGANIZATIONS, ETC.

86. *With reference to the ninth paragraph of Section 5 of the Act of September 8, 1916, as amended, how am I to determine to what extent contributions or gifts made to corporations or associations, organized exclusively for religious, charitable, scientific or educational purposes, societies for the Prevention of Cruelty to Children or Animals, may be claimed as a deduction?*

You should first ascertain what your taxable net income would be were you not entitled to a deduction on account of contributions or gifts made to such corporations, associations or societies, and then if the aggregate of your contributions and gifts made during the year to such organizations does not exceed fifteen per cent. of your taxable net income so computed, their aggregate amount may be entered in the space provided therefor under General Deductions on a personal return form. If such aggregate amount exceeds fifteen per cent. of your taxable net income so computed, the excess cannot be claimed.

For example: Your total taxable net income amounts to \$20,000. During the year you have contributed to the National Red Cross \$1,000, to the Young Men's Christian Association \$1,000, toward the construction of a new church \$1,000, and to the Associated Charities of your home city \$500, a total of \$3,500. Fifteen per cent. of your total net income amounts to \$3,000, therefore, this latter amount may be claimed as a deduction, and the balance of your contributions and gifts may not be claimed.

87. *During 1917 I contributed \$100 toward the support of a needy family. May this contribution be claimed as a deduction?*

Contributions of gifts made to individuals do not constitute allowable deductions.

PARTNERSHIPS

88. *Are partnerships subject, as such, to the Federal income tax and required to render annual income tax returns?*

No. Section 8 (e) of the Act of September 8, 1916, as amended by Section 1204 of the War Revenue Act states that:

"Persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of the partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise,

shall be returned for taxation and the tax paid under the provisions of this title."

This Section further states how the distributive share of partnership earnings or profits, which is taxable in the hands of the individual member, is to be ascertained.

While annual returns are not required of a partnership for income tax purposes, the Commissioner of Internal Revenue or any district collector is authorized to request at any time that a true and accurate return of a partnership's earnings, profit and income shall be made, excepting only the income which is exempt from taxation under the provisions of Section 4 of the Act of September 8, 1916, as amended, which income is specified in the answer to the 16th question. The required return shall set forth all the items of Gross Income and general deductions, and the names and addresses of the individuals who would be entitled to the net earnings, profits or income, if distributed, and the distributive share of each.

It is held that the income from a partnership accrues to the individual partner at the time his distributive interest is determined and reducible to possession. In the returns of income made by individuals for the calendar year, therefore, there should be included such income accruing from the business of the partnerships for their business or fiscal year as may have been definitely ascertained by means of a book balance, whether distributed or not. In other words, members of partnerships are required to make returns of income like other individuals for the calendar year, and should include in their returns the net proceeds of their interests in partnership profits ascertained at the end of the business year falling within the calendar year for which the individual return is being rendered.

89. *A partnership was organized in July, 1913, and in 1917 one of its individual members sold his interest therein and retired. How is he to determine the amount of gain or profit derived from the transaction which is returnable for income tax purposes?*

From the selling price should be deducted the amount of capital he has actually invested in the partnership's assets and the difference reported under Gross Income.

90. *What forms of income, if any, are subject to withholding of tax at the source when paid to a partnership?*

As the income received by a partnership is not subject to income tax in the hands of the partnership, no tax is to be withheld from income paid to a partnership, either domestic or foreign.

FIDUCIARIES

91. *Is the duly appointed guardian of a minor, or the conservator of an estate of an incompetent person, required to render personal returns for and in behalf of his ward?*

Yes, under the same conditions as would the ward if competent to act for himself, and in so doing the personal exemption to which the ward is entitled may be claimed.

92. *Is the duly appointed administrator of an estate of a deceased person, who died during the tax year, required to render a personal return for and in behalf of the deceased, and also his estate?*

If the net income of the deceased from January 1 of the year during which he died to the date of his death equalled or exceeded \$1,000, in the case of an unmarried person, or \$2,000 in the case of a married person, the administrator should file a personal return, executed on Form 1040, for and in behalf of the deceased, and a return executed on the same form will also be required of him for and in behalf of the estate, if it remains in process of administration and its net income from the date of the decedent's death to December 31, equals or exceeds \$1,000.

The administrator will be required to pay, and will be held liable for, any amount of tax which may be assessed against any such return rendered by him.

93. *Is the trustee having charge of a trust estate, the net income of which is regularly distributed among the beneficiaries, required to render a return?*

Yes, if any one of the beneficiaries is unmarried and his or her distributive interest in the net income of the trust equals or exceeds \$1,000. Yes, also, if all the beneficiaries are married and the distributive interest of any one equals or exceeds \$2,000. Otherwise, no.

It should be understood, however, that this answer is applicable only in a case where all the beneficiaries are citizens or residents of the United States. If any portion of the net income of an estate or trust is distributed to a non-resident alien beneficiary a return is required, and the normal income tax of 2% is to be deducted and withheld from so much of the amount remitted to such beneficiaries as was not derived from dividends or from the net earnings of corporations, joint-stock companies, etc., subject to a like tax, or has been subject to the withholding of the normal tax at the source.

94. *In a case where an estate is in process of administration and the fiduciary renders returns covering the income and deductions of the estate, and pays the amount of normal and additional tax assessed thereon, will the net income be subject to tax in the hands of the beneficiaries when received by them?*

No. The estate during administration is held to be a taxable entity; the fiduciary having it in charge is required to render returns and pay the taxes assessed thereon, and these taxes having once been paid, such income is exempt from tax in the hands of the beneficiaries who receive the same.

95. *Is any other than a return of income required of a fiduciary?*

Yes. Fiduciaries come within the provisions of Section 28 of the

Act of September 8, 1916, as amended by Section 1211 of the War Revenue Act, and will be required to render to the Commissioner of Internal Revenue a return of information, if, during the tax year, any income has been paid to an individual, partnership, corporation, joint-stock company, etc., equal to, or in excess of, \$800.

96. *Is a fiduciary required to deduct and withhold at the source any amount of normal income tax?*

Yes. If any distribution or payment of fixed or determinable gain, profit or income is made to a non-resident alien individual 2% is to be deducted and withheld.

97. *Is an ancillary administrator required to render income tax returns covering income received by him?*

An ancillary administrator is held to be merely the agent of the domiciliary administrator. The former should transmit to the latter all information as to income received by him in order that the domiciliary administrator may make a return covering the entire income of the estate.

98. *Have the beneficiaries of an estate or trust a right to inspect income tax returns rendered by a fiduciary covering the income of the estate or trust in which they are interested?*

An executor, administrator or trustee acts for his principal, and not for the beneficiaries of the estate of his principal; therefore, beneficiaries are not entitled, as such, to an inspection of returns of income filed by such a fiduciary.

99. *Who is liable for payment of the tax assessed against the net income of an estate or trust?*

Liability for payment of the income tax attaches to the person of the fiduciary up to and including the date of his discharge.

100. *I act as trustee of a trust estate. A part of the net income which accrues to the trust is retained and becomes a part of the corpus of the trust estate. Am I required to render a return for, and in behalf of, the trust other than the fiduciary return required of me?*

If the trust itself is named as a beneficiary and the amount of net income which accrues to it, as a beneficiary, equals or exceeds \$1,000, a return executed on Form 1040, for and in behalf of the trust, in addition to the return executed on Form 1041, is required.

101. *May an Executor or Administrator Render His Fiduciary Returns Prior to the Close of the Calendar Year in a Case Where the Estate is Finally Distributed and He is Discharged from, and Relieved of, his Trust During That Year?*

An administrator or executor may, immediately after his discharge

upon final accounting, file with the proper Collector of Internal Revenue a return covering the income and deductions of the estate for the period January 1 to the date of his discharge. To such a return there should be attached a certificate, under seal, setting forth the fact of the final accounting and discharge of the administrator or executor, and the tax assessed against that return may be paid immediately after receipt, from the Collector, of a notice of the amount assessed and a demand therefor. It should be understood, however, that if upon an audit of that return a further assessment of tax is made, the administrator or executor will be held liable for its proper payment.

WITHHOLDING OF TAX

102. *At What Rates and From What Income is the Normal Income Tax Now to Be Deducted and Withheld at the Source?*

All persons, corporations, partnerships, associations or insurance companies paying any amount of fixed or determinable gain, profit or income, other than that paid as dividends on the capital stock or from the net earnings, profits or income of corporations, joint-stock companies, etc., subject to a like tax, to a non-resident alien *individual* are required to deduct and withhold normal tax at the rate of two per cent. from the entire amount paid.

Normal income tax at the rate of six per cent. is to be withheld from all payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of domestic or other resident corporations, joint-stock companies, associations, or insurance companies, when paid to foreign corporations, joint-stock companies, associations or insurance companies having no office or place of business in the United States.

When dividends are paid upon the capital stock or from the net earnings of domestic or other resident corporations, joint-stock companies, associations or insurance companies, to foreign corporations, joint-stock companies, etc., having no office or place of business in the United States, normal tax at the rate of two per cent. is to be withheld.

No amount of tax is to be withheld from any payment of income made to a partnership, whether domestic or foreign.

The normal income tax is not to be deducted and withheld from any payment of income made to a citizen or resident of the United States except when derived from a bond, mortgage or other obligation issued by a domestic or resident corporation, which contains a contract or provision by which the obligor agrees to pay any portion of the tax imposed by the Federal Income Tax Law upon the obligee, or to reimburse the obligee for any portion of the tax which the obligor may be required or permitted to pay thereon, or to retain therefrom, under any law of the United States. That is, if interest is paid upon any obligation of a domestic or resident corporation, joint-stock company, etc., which contains a so-called "tax-free" or "no deduction" clause to a citizen or resident

of the United States normal tax at the rate of two per cent. is to be withheld, unless personal exemption is claimed and then only from the amount paid in excess of the exemption claimed.

A State, county, municipality or any other political subdivision of a State is not required to withhold any amount of income tax from interest which it may pay upon its own obligations, even though such interest is paid to non-resident alien individuals or foreign corporations.

103. *Is a Corporation Required to Actually Deduct and Withhold the Normal Income Tax from the Amounts of Interest it Pays on Bonds which Contain a So-Called "Tax Free" or "No Deduction" Clause; or May It Pay That Interest in Full and Hold Itself Liable for Payment of the Tax from Its Own Funds?*

The stipulation in the bonds of a corporation whereby the tax which may be assessed against them, or the income therefrom, is guaranteed, is held to be a contract wholly between the corporation and the bondholder. The debtor corporation will be held liable for the amount of tax due, whether that tax is actually deducted and withheld, or the interest paid in full and responsibility for payment of the tax assumed by the corporation.

104. *How May a Citizen or Resident of the United States Secure the Benefit of Personal Exemption to Which He is Entitled When Receiving a Payment of Interest on Bonds Containing a So-Called "Tax-Free" or "No Deduction" Clause?*

By attaching to the interest coupons an income tax exemption certificate and claiming thereon the amount of exemption desired. The amount of personal exemption claimed on such certificates during any one calendar year is not to exceed the total amount of personal exemption to which he is entitled.

RELEASE OF TAX HERETOFORE, BUT NOT NOW REQUIRED TO BE WITHHELD.

105. *Will I Be Required to Make a Return of, and be Held Liable for, the Amount of Normal Tax Which I Deducted and Withheld During the Year 1917, prior to the Passage of the War Revenue Act of October 3, 1917, from Income Paid to Citizens or Residents of the United States?*

No. Section 1212 of the Act of October 3, 1917, provides that any amount heretofore withheld by any withholding agent, as required by Title I of the Act of September 8, 1916, on account of the tax imposed upon the income of any individual, a citizen or resident of the United States, for the calendar year of 1917, except that withheld from interest paid on bonds containing a "tax-free" or "no deduction" clause, shall be released and paid over to such individual.

Therefore, any amount of normal tax withheld during the year 1917

from income paid to a citizen or resident of the United States, except interest on bonds and mortgages or deeds of trust, or other similar obligations of corporations, joint-stock companies, etc., containing a so-called "tax-free" or "no deduction" clause, may now be released and paid over to such individual and no return or payment of such tax will be required from the withholding agent.

RETURN AND PAYMENT OF TAX WITHHELD AT THE SOURCE

106. *How is Tax Withheld at the Source to be Returned and Paid?*

Debtor corporations withholding any amount of income tax from interest on "tax-free" obligations paid to citizens or residents of the United States, are required to report such payments on the prescribed Form to the Collectors for their Districts within twenty days after the close of the month during which the tax was withheld. This ruling is also applicable to any payments of interest made on corporate obligations, whether "tax-free" or not, made to non-resident alien individuals, foreign corporations, joint-stock companies, etc., having no office or place of business in the United States.

A return of the amount of tax withheld from payments of fixed and determinable gains, profits or income made to non-resident alien individuals, other than interest on corporate obligations, by individuals, citizens or residents of the United States, domestic or resident corporations, joint-stock companies, etc., is not required until after the close of the year during which the tax was withheld, but such returns are not to be filed later than March 1 of the next succeeding year.

The amount of tax assessed against such withholding returns as are rendered is to be paid by the withholding agent to the Collector of Internal Revenue for each district, after receipt from the collector of a notice of the amount assessed and demand therefor.

RETURNS OF INFORMATION

107. *From Whom are Returns of Information Required?*

Section 26, Act of September 8, 1916, as amended, provides that every corporation, joint-stock company or association or insurance company subject to the Federal Income Tax on its own income, shall, when required by the Commissioner of Internal Revenue, render a correct return, duly verified under oath, of its payments of dividends, whether made in cash or its equivalent or in stock, which return shall give the names and addresses of the stockholders, the number of shares owned by each, the aggregate amount of dividends received by each, and the tax years and the applicable amounts in which such dividends were earned.

Section 27, same Act, provides that every person, corporation, part-

nership or association, doing business as a broker on any exchange or board of trade or other similar place of business shall, when required by the Commissioner of Internal Revenue, render a correct return, duly verified under oath, showing the names and addresses of customers for whom any business has been transacted, with such details as to profits, losses or other information which the Commissioner of Internal Revenue may require to enable him to determine whether all income tax due on profits or gains of such customers has been paid.

Section 28, same Act, provides that all persons, corporations, partnerships, associations and insurance companies, making a payment to any person, corporation, partnership, association or insurance company, of interest, rent, salaries, wages, premiums, or other items of fixed and determinable gains, profits and income (other than dividends on stocks or gains or profits derived from transactions on any exchange or board of trade, or other similar place of business) of 800 dollars or more during any calendar year, shall render a true and accurate return covering the payments made, which return shall disclose the names and addresses of the recipients of such payments and the aggregate amount paid to each during the calendar year.

Under this Section returns of information will also be required, regardless of amounts paid, in the case of payments of interest upon bonds and mortgages or deeds of trust or other similar obligations of corporations, joint-stock companies, associations and insurance companies and, also, in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon bonds and dividends from the stock of foreign corporations, from all persons, corporations, partnerships or associations which undertake as a matter of business or profit the collection of foreign payments of interest or dividends by means of coupons, checks or bills of exchange.

Under the provisions of Section 9 of the Act of September 8, 1916, as amended, no person, corporation, partnership or association can undertake as a matter of business or for profit the collection of foreign payments of interest or dividends by means of coupons, checks or bills of exchange without first obtaining a license from the Commissioner of Internal Revenue, and whoever knowingly undertakes to collect such payments, as aforesaid, without having obtained a license therefor, or without complying with prescribed regulations, shall be deemed guilty of a misdemeanor and for each offense be fined in a sum not exceeding \$5,000, or imprisoned for a term not exceeding one year, or both, in the discretion of the court.

The returns which will be required under the provisions of Sections 26, 27 and 28 are to be rendered under such rules and regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, which rules and regulations are now in course of preparation and will soon be announced.

THE CORPORATION TRUST COMPANY

FEDERAL TAX SERVICES.

INCOME TAX SERVICE.

The Income Tax Service collects rulings, regulations, opinions and decisions from all Federal official sources, bearing on the administration and interpretation of the provisions of the income tax law of September 8, 1916, as amended, including the tax on undistributed profits of corporations, and the war income tax law of 1917.

WAR TAX SERVICE.

The War Tax Service similarly collects and reports the rulings, regulations, opinions and decisions on the war excess profits tax, the war stamp taxes, the capital stock tax, the estate tax, the war tax on facilities furnished by public utilities, the war tax on insurance, the war excise taxes, the war tax on admissions, and the special taxes on occupations.

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For the Income Tax Service, at the beginning of each year, a compilation is made of all matters previously issued then in force, so arranged that the rulings, regulations, etc., bearing on any given point may be found in one place. This compilation enables the reader to examine at a glance that for which he would otherwise search through many pages. The compilation contains no repealed or superseded matter. The language of the official documents, without comment or conclusions of others, is used. The matter is arranged under headings and subheadings that follow naturally the arrangement of the law. The compilation, supplemented by the

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CONTENTS.

The Income Tax Service is devoted exclusively to the income tax law, amendments thereto and the regulations bearing thereon.

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